

## Module 9 - Tax Credit for Child and Dependent Care Expenses

# Tax Tutorial

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In this tax tutorial, you will learn about the [tax credit](#) for child and dependent care expenses.

A tax credit is a dollar-for-dollar reduction of the tax.

The tax credit for child and dependent care expenses allows taxpayers to claim a credit for expenses paid for the care of

- children under age 13
- a disabled spouse or dependent

To claim the credit, there are requirements for the:

- taxpayer
- child or dependent
- expenses

There is a limit to the amount of qualifying expenses. The credit is a percentage of the qualifying expenses.

---

next ►

## Module 9 - Tax Credit for Child and Dependent Care Expenses

### Tax Deduction vs. Tax Credit

#### Tax Deduction

A tax deduction reduces income subject to tax.

For each dollar of tax deduction, the reduction in tax liability is less than a dollar.

Assume that the tax rate is 15 percent and the tax deduction is \$200.

#### The Effect of Deductions on Income Subject to Tax

	Without Deduction	With Deduction
Income Subject to Tax	\$10,000	\$9,800
Tax at 15%	\$1,500	\$1,470

At a 15 percent tax rate, a \$200 **tax deduction** results in a \$30 reduction in the tax.

#### Tax Credit

A tax credit is a dollar-for-dollar reduction in the tax liability.

For each dollar of tax credit, there is a dollar reduction in the tax liability.

Continuing with the example, assume that the tax credit is \$200.

#### The Effect of Deductions and Credits on Income Subject to Tax

	Without Deduction With Credit	With Deduction Without Credit
Tax	\$1,500	\$1,470
Tax Credit	-(200)	0

Total Tax	\$1,300	\$1,470
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A \$200 **tax credit** results in a \$200 reduction in the tax liability. This is a dollar-for-dollar reduction in the tax liability.

With a \$200 **tax deduction**, the total tax is \$1,470.

With a \$200 **tax credit**, the total tax is \$1,300.

The taxpayer pays less tax with a \$200 tax credit than with a \$200 tax deduction.

[< previous](#)[next >](#)

## Module 9 - Tax Credit for Child and Dependent Care Expenses

The tax credit for child and dependent care expenses allows taxpayers to claim a credit for expenses paid for the care of:

- children under age 13
- a disabled spouse or dependent

Be patient as you learn about the qualifications needed in order to claim the credit.

 [previous](#)

[next](#) 

## Module 9 - Tax Credit for Child and Dependent Care Expenses

### Taxpayer Requirements

To qualify, the taxpayer must:

- incur the expenses in order to work or look for work
- earn income for work performed during the year (see the earned income exception)
- file a joint return, if married
- maintain a home that was also the home of a qualifying person
- pay the expenses to someone other than
  - a) the taxpayer's child under age 19
  - b) the taxpayer's dependent claimed on the tax return

◀ previous

next ▶

## Module 9 - Tax Credit for Child and Dependent Care Expenses

### Taxpayer Requirements—Exceptions

#### Earned Income Exception

A spouse is considered to earn income if the spouse is:

- a full-time student for some part of each of five months of the year (the months do not have to be consecutive), or
- incapable of self-care.

#### Married Filing a Joint Return Exception

Married taxpayers do not have to file a joint return to receive the credit if:

- the taxpayer is legally separated or married living apart from the spouse,
- the taxpayer files separate return,
- the taxpayer paid more than half the cost of keeping up a home for the taxpayer and the qualifying person,
- the qualifying person lived in the home for more than half the year, and
- the taxpayer's spouse did not live in the home during the last six months of the year.

◀ previous

next ▶

## Module 9 - Tax Credit for Child and Dependent Care Expenses

### Quick Check!

Answer the following multiple-choice questions about the tax credit for child and dependent care expenses by clicking on the correct answers. To assess your answers, click the *Check My Answers* button at the bottom of the page.

1 ) A tax credit

- A. increases income subject to tax. *No answer given: the correct answer is D. A tax credit reduces the tax. A tax deduction reduces the income subject to tax.*
- B. reduces income subject to tax.
- C. increases the tax.
- D. reduces the tax.

2 ) Troy and Karsyn are married and file a joint return. They are both employed outside of the home. They pay their 16-year-old daughter to care for their 7-year-old son when he gets home from school.

- A. Troy and Karsyn qualify to claim the credit for child and dependent care expenses. *No answer given: the correct answer is C*
- B. Troy and Karsyn do not qualify to claim the credit for child and dependent care expenses because the care is provided in their home.
- C. Troy and Karsyn do not qualify to claim the credit for child and dependent care expenses because the expenses are paid to their child who is under 19 years of age.
- D. Troy and Karsyn do not qualify to claim the credit for child and dependent care expenses because their daughter is a full-time student.

 previous

next 

## Module 9 - Tax Credit for Child and Dependent Care Expenses

### Child or Dependent Requirements

To qualify for the credit, the taxpayer must furnish more than half the cost of maintaining a home that is also the home of a qualifying person.

A qualifying person is one of the following:

- a child under the age of 13, at the time of the care, for whom a dependency exemption is claimed
- a person who is physically or mentally incapable of self-care and who could be claimed as a dependent if his or her gross income was less than the exemption amount
- a spouse who is physically or mentally incapable of self-care

**Tax Tip:**

*There are special rules for children of divorced or separated parents.*

◀ previous

next ▶



## Module 9 - Tax Credit for Child and Dependent Care Expenses

### Expense Requirements

To claim the credit, the following expenses are allowed:

- household services including cook, maid, babysitter, housekeeper, or cleaning person, if the services were partly for the care of the qualifying person
- care of the qualifying person including services provided outside of the home, as long as the qualifying person spends at least eight hours a day in the home
- day care for children
- daytime dependent care center for adults

The following expenses are not allowed:

- services of a gardener or chauffeur
- attending kindergarten or a higher grade are not expenses for care
- food, clothing, education, and entertainment unless they are incident to and cannot be separated from the cost of caring for the qualified person
- cost of transportation for the care provider to come to your home or to go back and forth to the care location
- overnight camp

 [previous](#)

[next](#) 

## Module 9 - Tax Credit for Child and Dependent Care Expenses

The expenses eligible for the credit are the lowest of:

- the actual expenses paid
- the single taxpayer's earnings
- if married, the lower-paid spouse's earnings

Note: The income of a spouse who is a full-time student or incapable of self-care is considered to be \$250 per month (one qualifying person) or \$500 per month (two or more qualifying persons).

- the overall limit of \$3,000 a year for one qualifying person or \$6,000 a year for two or more qualifying persons

The overall limit is reduced, dollar-for-dollar, by any dependent care assistance received from the employer.

 [previous](#)

[next](#) 

## Module 9 - Tax Credit for Child and Dependent Care Expenses

### Quick Check!

Answer the following multiple-choice questions about the tax credit for child and dependent care expenses by clicking on the correct answers. To assess your answers, click the *Check My Answers* button at the bottom of the page.

1 ) While he was away at work, Julio paid someone to care for his wife, who is physically unable to care for herself. Julio also paid to have someone prepare meals for his 14-year-old son. Julio can claim a credit for child and dependent care expenses for

- A. his wife. **No answer given: the correct answer is A**
- B. his son.
- C. both his wife and his son.
- D. neither his wife nor his son.

2 ) Ronald and Joan are married and lived together the entire year. They file a joint return. They have a two-year-old son who spends 20 hours a week in day care. Ronald is a full-time student. Joan works as a paralegal.

- A. Ronald and Joan can claim a credit for child and dependent care expenses. **No answer given: the correct answer is A**
- B. Ronald and Joan cannot claim a credit for child and dependent care expenses because Ronald does not have any earned income.
- C. Ronald and Joan cannot claim a credit for child and dependent care expenses because the care is provided outside of the home.
- D. Only Joan can claim a credit for child and dependent care expenses if she uses the married filing a separate return filing status.

3 ) Chuck earned \$28,000, and his wife, Trudy, earned \$4,400. Day care expenses for their children were \$5,000. The expenses qualifying for the credit for child and dependent care are

- A. \$5,000 **No answer given: the correct answer is C**
- B. \$4,800
- C. \$4,400
- D. \$2,500

## Module 9 - Tax Credit for Child and Dependent Care Expenses

The tax credit for child and dependent care expenses is a percentage of the qualifying expenses.

The range is from 20 to 35 percent of the qualifying expenses.

The percentage depends on the taxpayer's income.

 [previous](#)

[next](#) 

## Module 9 - Tax Credit for Child and Dependent Care Expenses

Let's look at the tax form used to claim the tax credit for child and dependent care expenses for Ruth and Aaron Schultz.

Form **2441** **Child and Dependent Care Expenses** OMB No. 1545-0074  
 Department of the Treasury Internal Revenue Service (99) **2007** Attachment Sequence No. 21  
 ▶ Attach to Form 1040 or Form 1040NR. ▶ See separate instructions.

Name(s) shown on return **Aaron and Ruth Schultz** Year social security number **222 33 4444**

**Before you begin:** You need to understand the following terms. See Definitions on page 1 of the instructions.  
 • Dependent Care Benefits • Qualifying Person(s) • Qualified Expenses

**Part I** Persons or Organizations Who Provided the Care—You must complete this part. (If you have more than two care providers, see the instructions.)

1	(a) Care provider's name	(b) Address (number, street, apt. no., city, state, and ZIP code)	(c) Identifying number (SSN or EIN)	(d) Amount paid (see instructions)
	<b>A-1 Daycare</b>	<b>2158 Centre Way Any Town, USA xxxxx</b>	<b>10-2341068</b>	<b>3,880 00</b>

Did you receive dependent care benefits? ☐ No ☐ Yes  
 No → Complete only Part II below.  
 Yes → Complete Part III on the back next.

**Caution.** If the care was provided in your home, you may owe employment taxes. See the instructions for Form 1040, line 62, or Form 1040NR, line 57.

**Part II** Credit for Child and Dependent Care Expenses

2 Information about your qualifying person(s). If you have more than two qualifying persons, see the instructions.

(a) Qualifying person's name		(b) Qualifying person's social security number	(c) Qualified expenses you incurred and paid in 2007 for the person listed in column (a)
First	Last		
<b>Hannah</b>	<b>Schultz</b>		<b>2,180 00</b>
<b>Henry</b>	<b>Schultz</b>		<b>1,700 00</b>

3 Add the amounts in column (c) of line 2. Do not enter more than \$3,000 for one qualifying person or \$6,000 for two or more persons. If you completed Part III, enter the amount from line 35 **3,880 00**

4 Enter your earned income. See instructions **17,200 00**

5 If married filing jointly, enter your spouse's earned income (if your spouse was a student or was disabled, see the instructions); all others, enter the amount from line 4 **8,600 00**

6 Enter the smallest of line 3, 4, or 5 **3,880 00**

7 Enter the amount from Form 1040, line 38, or Form 1040NR, line 38 **26,700 00**

8 Enter on line 8 the decimal amount shown below that applies to the amount on line 7

If line 7 is:			If line 7 is:		
Over	But not over	Decimal amount is	Over	But not over	Decimal amount is
\$0—15,000		.35	\$29,000—31,000		.27
15,000—17,000		.34	31,000—33,000		.26
17,000—19,000		.33	33,000—35,000		.25
19,000—21,000		.32	35,000—37,000		.24
21,000—23,000		.31	37,000—39,000		.23
23,000—25,000		.30	39,000—41,000		.22
25,000—27,000		.29	41,000—43,000		.21
27,000—29,000		.28	43,000—No limit		.20

9 Multiply line 6 by the decimal amount on line 8. If you paid 2006 expenses in 2007, see the instructions **1,125 00**

10 Enter the amount from Form 1040, line 44, or Form 1040NR, line 41 **10**

11 Enter the amount from Form 6251, line 31 (see instructions) **11**

12 Subtract line 11 from line 10. If zero or less, stop. You cannot take the credit **12**

13 Credit for child and dependent care expenses. Enter the smaller of line 9 or line 12 here and on Form 1040, line 47, or Form 1040NR, line 44 **13**

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- Part 1 shows the caregiver-A-1 Day Care.
- Part 2
  - a) Line 2 shows the qualifying persons-Hannah and Henry-and the qualifying expenses for each person.
  - b) Lines 4 and 5 show the earned income for Aaron and Ruth.
  - c) Line 6 is the lowest of qualifying expenses and the earned incomes.
  - d) Line 7 is the adjusted gross income shown on the tax return.
  - e) Line 8 is the percentage from the table.
  - f) Line 9 is the tax credit.

Aaron and Ruth can claim a tax credit of \$1,125.00. Their tax will decrease by \$1,125.00.

 [previous](#)

[next](#) 

## Module 9 - Tax Credit for Child and Dependent Care Expenses

### Lesson Summary

A tax credit is a dollar-for-dollar reduction of the tax.

The tax credit for child and dependent care expenses allows taxpayers to claim a credit for expenses paid for the care of

- children under age 13
- a disabled spouse or dependent

To claim the credit, requirements must be met for the

- taxpayer
- child or dependent
- expenses

There is a limit to the amount of qualifying expenses.

The credit is a percentage of the qualifying expenses.

 [previous](#)

---

## Module 9 - Glossary

## Glossary

***tax credit***—a dollar-for-dollar reduction in the tax. Can be deducted directly from taxes owed.

 [previous](#)

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